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NEWSLETTER: Important Information for California Branded Gasoline Retailers

SPECIAL INTEREST

U.S. APPELLATE COURT RULES IN FAVOR OF RETAILERS OVER IRS
Court rules in Westpac v. Commissioner that upfront cash advanced to retailers by suppliers may be declared as a liability loan instead of income on tax returns

30 DAY LIMIT UPHELD
Dealer franchisees must adhere to stricter common law standards instead of more lenient PMPA standards when seeking preliminary injunctions against franchisors and may lose rights if they delay.

ABC STING OPERATION
The Alcoholic Beverage Control Board kicks off a minor decoy sting operation on August 22nd

ULSD LABELS
Shell recommends that California Ultra-low-sulfur diesel fuels marketers use labels

VIDEO ADVERTISING BAN
Chevron bars dealers from adding advertising video screens to fuel islands until the company decides on “approved content”

Branded Dealer Special Report

Retailers Prevail Over IRS In Federal Appeals Court Battle

UPFRONT CASH A WIN FOR MARKETERS

The California 9th Circuit U.S. Appeals Court has ruled in a retailer's favor in the battle with the IRS over how to treat upfront cash advanced by suppliers to upgrade or rebrand retail outlets. The "loan" that often amounts to hundreds of thousands of dollars is usually given as an incentive to signing a new long-term branded supply contract. These advances were common among the major brands a few years ago and are still seen for branding high volume locations.

Dealers have argued that these advances should be treated as a loan that has to be repaid over time even though they are forgiven if the dealer meets a monthly or annual minimum purchase requirement. Treating the advance as a loan instead of income allows the dealer to push the tax owed on the money out to a future date when the loan is actually forgiven by the oil company, and the dealer would not have to pay taxes on it if they fail to meet refiner volume requirements and end up having to repay the loan

The IRS has repeatedly disallowed and penalized dealers for taking that position on their income tax returns. The IRS has held that the money is not a loan and must be recognized as income in the year it was received and then offset in future years by depreciation of the assets bought with the cash.

Now the California Court has held that the IRS was wrong. The ruling in Westpac v. Commissioner (2006-2 USTC 50,369, June 21, 2006) involves a grocery chain but the principle is the same and overturns a previous U.S. Tax Court decision that upheld the IRS position. WestPac had received cash advances from four venders to carry their products at its retail stores. The agreement with the vendors required that WestPac repay a portion of the loan if it failed to meet the minimum purchase requirements.

Westpac did not declare the cash as income, but as a liability (loan) and applied the advance as a purchase discount each time it made a purchase from the supplier. This reduced the cost of goods sold and increased the margin and taxable profits from sales over the term of the agreement. When Westpac terminated some of the supply contracts (those who didn't meet the minimum purchase requirement), it repaid the unearned advances.

The Court used a humorous analogy: "Imagine a simple hypothetical. Harry Homeowner goes to the furniture store, spots just the right dining room chairs for $500 each, and says 'I'll take four, if you give me a discount.' Negotiating a 25% discount, he pays only $1,500 for the chairs. He has not made $500, he has spent $1,500. Now suppose Harry Homeowner is short on cash, and negotiates a deal where the furniture store gives him a 20% discount as a cash advance instead of the 25% off. This means the store gives him $400 'cash back' today, and he pays $2,000 for the four chairs when they are delivered shortly after the first of the year. Harry cannot go home and say 'I made $400 today' unless he plans to skip out on his obligation to pay for the four chairs. Even though

he receives the cash, he has not made money by buying the chairs. He has to sell the chairs for more than $1,600 if he wants to make money on them. The reason why the $400 'cash back' is not income is that, like a loan, the money is encumbered with a repayment obligation to the furniture store and the 'cash back' must be repaid if Harry does not perform his obligation. Were a company to get very significant amounts of up front cash discounts on its obligation to purchase goods in the future and tell stockholders and prospective stock purchasers that it had 'made' this much 'income,' investors would be sorely disappointed to learn that all the money had to be paid back if their company did not sell all the goods it had promised to sell in the future. The company would be like Harry Homeowner claiming to have 'made' $400 when he received his cash advance discount on the four chairs. Harry might have to spend the night on the couch, but the CEO could spend the night in jail."

The principal is the same for Dealers who attempted to claim the income in the year that the repayment was forgiven and like WestPac they were required by the IRS auditors to do more than spend the night on the couch. Taxes, interest and penalties were demanded. Dealers who paid the full tax up front can amend their income taxes for the past three years, and in certain cases as far back as six years.

DEALER FILES PMPA SUIT TOO LATE

Esso Standard Oil Co. v. Monroig-Zayas, No. 05-1254 (1st Circuit, April 12, 2006)

A federal appeals court has again held that a dealer waited too long to file for a preliminary injunction to stop the oil company from terminating his station franchise pending trial on the alleged violation of the PMPA (CLL 139, Ripplinger v. Amoco Oil Co. (8th Cir. 10/10/90)). The ruling should again serve as a warning to dealers against delay in asserting their legal rights.

The Appeals Court held that the lower Court's denial of preliminary injunction to maintain a franchise agreement was proper, and that the common law standard for preliminary injunctions applied, instead of the much easier PMPA standard, because of the untimely nature of the injunction application, and where the defendant was unable to demonstrate a substantial likelihood of success on the merits.

Facts: Monroig ran an Esso gas station as a lessee franchisee in Puerto Rico. Esso sent Monroig a contract for a new three-year lease that would begin on January 1, 2004. Under this contract, the rent increased by about five percent for each of the first two years and required the removal of a radiator repair shop from the premises and had a prohibition against assignment or sublease of the premises. Monroig disputed the terms of the renewal. Esso sent Monroig a notice of nonrenewal based on the parties' failure to agree to the terms of the renewal but Esso granted five short-term extensions to the prior contract. The last extension expired on June 30, 2004, and since the parties had not come to an agreement, Esso stopped delivering gasoline the next day. Monroig filed suit and requested a preliminary injunction from the Court on September 9th.

Ruling: Under the PMPA, the franchisor must provide adequate notice to the franchisee of the nonrenewal of the franchise agreement. The general rule is that notice must be given at least 90 days before the nonrenewal takes effect. 15 U.S.C. § 2804(a) (2). Esso gave Monroig a written notice 90 days before the end of the three year franchise term.

In a partial victory for dealers, the Court found that the time for filing for an injunction was extended by the continuing negotiations for a new franchise agreement and lease, but the dealer must then file for an injunction within 30 days of the end of negotiations without agreement to the renewal terms.

The PMPA offers a preliminary injunction standard to franchisees that is more forgiving than the common law standard. The PMPA only requires that the Dealer show that he has some basis for a claim that the oil company violated the PMPA and that the hardship if the injunction is not granted falls harder on the dealer than on the oil company, but in order to take advantage of this more forgiving standard, the franchisee's request must be timely.

Monroig did not know the definitive date of the nonrenewal until the contract negotiations permanently ceased. The PMPA requires the franchisor to include in its notice "the date on which...nonrenewal takes effect." Id §2804(c)(3)(B). Under these circumstances, the Court found that Esso gave notice to Monroig of the definitive date of nonrenewal on the earliest reasonably practicable date. See id §2804(b) (1), i.e. the date of expiration of the last extension to negotiate, and that a franchisor who initially satisfies the notice requirements of §2804(a)(2) and then continues negotiations with a franchisee is not penalized for its efforts to reach a compromise agreement. In addition, a franchisee is not required to file a preliminary injunction motion while negotiations are ongoing, which would not be conducive to fostering an agreement between the parties.

Where Monrig went wrong was to wait from June 30 to September 9th to file his lawsuit and seek an injunction against Esso. This was far beyond 30 days after the termination. Had he filed within 30 days of the actual termination, he may have gotten his injunction because he would only have had to show a basis for litigation. As it was, since he delayed he had to show the likelihood that he would succeed in proving that Esso violated the PMPA, a much more difficult standard that he was not able to meet.

Recommended procedures: Dealers who want to remain in the station while a court determines whether the franchisor has lawfully terminated their franchises must act very quickly. The standard notice is 90 days for nonrenewals but in some cases a shorter notice, as little as a few days, can be given, especially in termination for cause. If you get a notice of nonrenewal or termination:

1. Don't wait, thinking you can talk the company out of it. Contact an attorney who is familiar with the PMPA;

2. Don't wait until a few days before the termination or nonrenewal date. It will take your lawyer some time to

prepare and file a lawsuit and motion for a preliminary injunction;

3. If you received a short notice of less than 90 days, you must file your lawsuit within 30 days of the actual non-renewal or termination date, or you may not get your injunction, even if you have a possible case against the oil company;

4. If you leave a station and think you might want to sue for damages, do not wait too long to see your lawyer: there is a one year statute of limitations under the PMPA.

ALERT- ABC MINOR DECOY STING OPERATIONS

The Department of Alcoholic Beverage Control (ABC) will kick off their minor decoy sting operations in a press conference on August 22 in Sacramento. The ABC received a $2 million grant from the Office of Traffic Safety (OTS) to implement a minor decoy program. Agencies conducting minor decoy sting operations are: Bakersfield PD, Buena Park PD, Contra Costa County, Corona PD, El Cajon PD, Elk Grove PD, La Vern PD, Laguna Beach PD, Lake Elsinore, Livermore PD, Los Angeles PD, Moreno Valley PD, Mountain View PD, Nevada County Sheriff, Palo Alto PD, Pasadena PD, Placer County Sheriff, Rocklin PD, San Bernardino PD, San Bruno PD, San Diego County- Poway, Ramona, Julian, Santee, Lakeside, El Cajon, Vista and San Diego PD, San Jose PD, Santa Rosa PD, Selma PD, Shasta County Sheriff, Vallejo PD and the Whittier PD.

The Minor Decoy Program allows local law enforcement agencies to use persons under 20 years of age as decoys to attempt to purchase alcoholic beverages from licensed premises. In 1994, the California Supreme Court ruled that the use of minor decoys was not entrapment and did not violate due process requirements.

If an employee of your store is caught selling alcohol to a minor the consequences are serious:

1. Sale or service of alcoholic beverages to a minor or an obviously intoxicated person is not only grounds for discipline by the ABC Board, but constitutes a criminal offense. The seller could be arrested, charged with a crime, and face a fine, community service work or imprisonment in county jail;

2. The law requires the suspension of a license for a second or subsequent violation within a 36-month period and authorizes the revocation of a license for a third violation within a 36-month period. ABC may at times revoke a license before a 3rd violation;

3. A violation of law or loss of the license may violate your franchise agreement and may be grounds for termination of the franchise;

Be aware that these operations are taking place and train your staff to check IDs.

SHELL RECOMMENDS ULSD MARKETERS USE LABELS

Ultra-low-sulfur diesel fuel is being phased in nationwide. Many states will allow the sale of both 15 ppm and 500 ppm diesel and in those states the EPA requires that pumps be labeled as to which diesel is being sold. Existing vehicles can use either fuel but 2007 model vehicles will require 15 PPM ULSD.

California is exempt from the EPA labeling requirement because only 15 ppm diesel fuel will be permitted to be sold in the state. Shell will, however, carry the labels on dispensers at California company operated stations and recommends that Shell branded dealers and jobbers do the same.

CHEVRON BARS MARKETERS FROM INSTALLING VIDEO SCREENS

Vendors of video screens that carry advertising to be installed inside convenience stores and outside as dispenser toppers or on a canopy column are out signing up dealers.

Chevron has told its dealers that they cannot add video screens at the fuel islands -- or sign deals with vendors to do so -- until the company decides on "approved" video content.

The video vendors usually sell the advertising and feed the video to the screens via an internet connection. The "content" consists of three or four-minute video loops offering traffic, weather, sports, or news, but most importantly advertising. The dealer has little or no control over advertisers or content. The appeal for the dealer is a fixed monthly income and the dealer may be allowed his own advertising segment for his store specials, car washes, etc.

While many franchise agreements restrict a dealer's right to place signs on the premises, most do not directly address this new type of "video sign."

Video screens are "unauthorized" according to Chevron image standards. The company wants to control this new source of advertising income and is evaluating options, including vendors, equipment specs and message content, and expects to "declare an approved pump island hardware and video content solution" later this year.

Recommendations:

1. Review the restrictions on signs, advertising, or alterations in your franchise agreement;

2. Don't sign an agreement unless it is subject to approval by your franchisor or to cancellation if your franchisor does not approve and issues a default notice;

3. Try to get the right to veto content if it is inappropriate or is objected to by your franchisor;

4. Have the contract reviewed by an attorney familiar with petroleum marketing franchise agreements before you sign.

ABOUT OUR FIRM

Attorneys Guy Gilbert, James Bachor and David Lantzer practice in the petroleum marketing and automotive service field with an emphasis on California law and Federal PMPA advisement / litigation.

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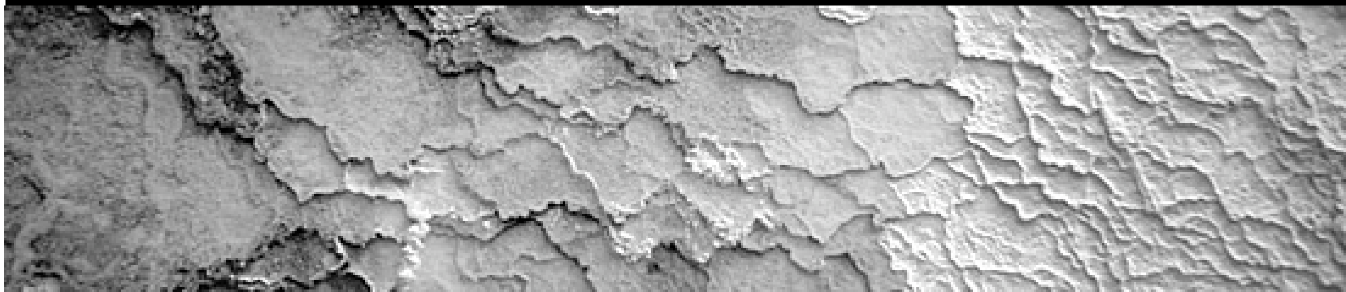

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